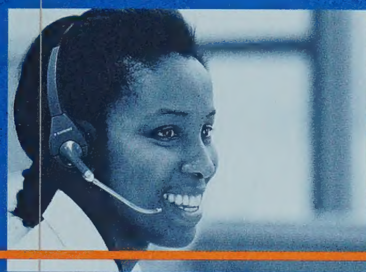
SurreyMetroSavings



building for today with an eye to tomorrow

1997 Annual Report

About the Company

Surrey Metro Savings was incorporated in 1947 and has grown to become Canada's second largest Credit Union, with more than $1.9 billion in assets.

The Company provides a full range of retail banking services. It also operates a Commercial Lending Unit. Surrey Metro Savings provides its services through 17 retail branches and a centralized telephone call centre serving the communities of Surrey, Langley, Fort Langley, White Rock, Delta, Abbotsford, and Chilliwack. These communities comprise the Fraser Valley region, with a population of approximately 700,000. It is one of the fastest growing areas in Canada. The region's population is expected to grow by about 15% during the next five years.

The Company also owns Metro Insurance Services Ltd., which operates five insurance offices, and Shoreline Projects Ltd., a property development subsidiary. Surrey Metro Savings is incorporated under the Credit Union Incorporation Act of British Columbia and also operates under the regulations of the Financial Institutions Act of British Columbia. At Surrey Metro Savings depositors are protected up to $100,000 by the Credit Union Deposit Insurance Corporation of British Columbia. The Company is an investor-owned institution with Non-Voting Shares listed on The Toronto Stock Exchange and trading under the symbol SMS.

Corporate Highlights

Year 2000 Challenge

The Company implemented a strategy to cope with the challenges of Year 2000. In 1997, the assessment phase commenced in order to determine the complexity and the effort that will be required to address the issues. The Company's overall strategy encompasses hardware, in-house computer and embedded systems, vendors, customers, and suppliers. The target completion date for the entire project is the middle of 1999.

Change Management in the Financial Services Industry

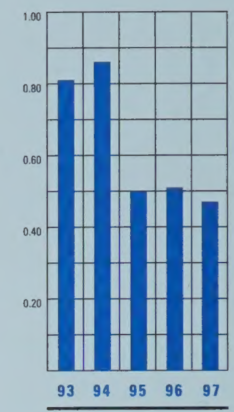
The Company is well aware of the changes facing the financial services industry due to economic and technological factors. The cost of technology and the shrinking of margins require flexibility and adaptability from all employees of the corporation. Management recognizes this and is facilitating change through educational support and effective communication.

Mutual Funds

Mutual funds proved to be a viable investment vehicle for customers in 1997. Ethical funds and some third-party mutual funds are offered in all branches and additional third-party mutual funds are available through certified financial planners employed by the Company's wholly owned subsidiary, Metro Insurance Services Ltd.

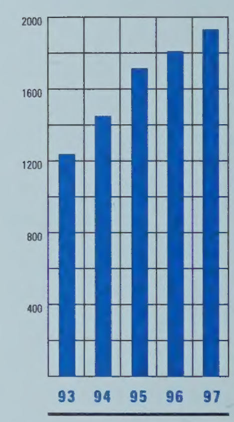
Call Centre Update

The Call Centre continues to be an effective and efficient service for the Company's customers. Plans are underway to expand the Call Centre to include full lending and insurance services.



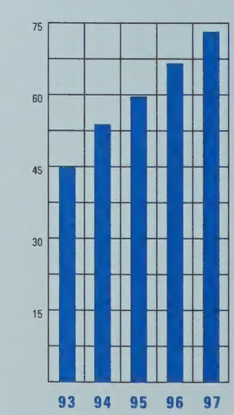
Return on Average Assets
in percent

Flat earnings and increased assets resulted in a slightly lower ROAA at 0.47% versus 0.51% in 1996.



Assets
in millions of dollars

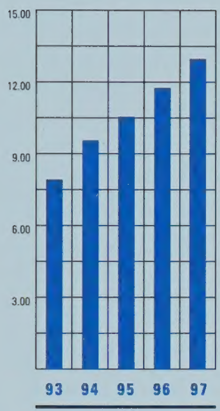
Asset growth was 6.7% as compared to 5.5% in 1996.



Non-Voting Shareholders' Equity
in millions of dollars

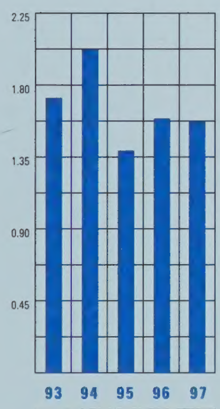
Shareholders' equity grew by 9.9%.

Financial Highlights



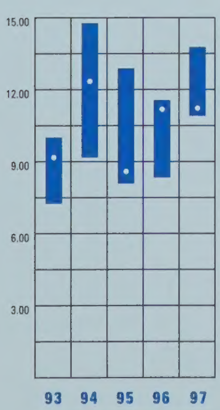
Book Value Per Non-Voting Share
in dollars

Book value increased by $1.17 as a direct result of earnings retained.



Earnings per Non-Voting Share
in dollars

Decreased real estate activity and competition for deposits led to flat earnings per share performance.



Non-Voting Shares Trading Ranges
in dollars

◦ close (December 31)

December 31	% Change	1997	1996
in thousands of dollars **Balance Sheet**			
Assets	6.7	**1,929,377**	1,808,167
Loans	7.7	**1,668,350**	1,548,486
Deposits[1]	6.4	**1,723,157**	1,619,261
Shareholders' Equity[1]	9.9	**73,147**	66,537
in thousands of dollars **Results of Operations**			
Net Interest Income	1.0	**43,889**	43,463
Other Income	13.8	**15,068**	13,235
Non-Interest Expenses	5.9	**46,135**	43,584
Net Income	(2.5)	**8,875**	9,105
Financial Statistics			
in percent Operating Efficiency		**78.30**	76.90
in percent Return on Average Equity		**12.70**	14.42
in percent Return on Average Assets		**0.47**	0.51
in dollars Earnings Per Share[2]		**1.57**	1.61
in dollars Earnings Per Share Fully Diluted		**1.53**	1.59
Dividends			
in percent Preferred Shares		**4.90**	6.19
in dollars Non-Voting Shares		**0.40**	0.40
in dollars **Non-Voting Shares**			
High		(February 13) **13.75**	11.55
Low		(December 19) **10.90**	8.40
Close (December 31)		**11.10**	11.20
Book Value		**12.92**	11.75

[1] *See Note 2 of Notes to Consolidated Financial Statements.*
[2] *Based on weighted-average of non-voting shares, 5,663,672 issued.*

Report to Shareholders

Surrey Metro Savings completed its fiftieth year in sound financial condition. During the year the Company was faced with a relatively flat real estate market, and increased competition for deposits from alternative investment products such as mutual funds. Although we produced slightly less net income than in the preceding year, we ended the year with a strong capital base, a healthy loan portfolio, and a highly competitive organization.

Earnings

Surrey Metro Savings' net income for 1997 was $8.9 million, down 2.5% from the $9.1 million achieved in 1996. Earnings per share were $1.57, down from $1.61. Interest expense, year-over-year, decreased more than interest income, resulting in slightly larger net interest income. However, expressed as a percentage of average assets, net interest income decreased from 2.45% to 2.35% on a year-over-year basis. This increase in net interest income would have been larger had it not been for the low interest rate environment which made it difficult to encourage customers to keep their funds in deposits. This forced the Company to utilize its bank lines, which is a more expensive form of funding. Other income showed healthy growth of 13.8% with non-interest expenses up 5.9%. We are not satisfied with the expense growth in the year and will strive in the future to grow our expenses at a lower rate than that achieved in 1997.

Balance Sheet

Total assets as at December 31, 1997 were $1.9 billion, up 6.7% from $1.8 billion in 1996. Loans increased by 7.7% to $1.7 billion net of the sale of $33 million in mortgages. Deposits grew by 6.4% to $1.7 billion. Non-voting shareholders' equity increased by 9.9% to $73.1 million. A detailed discussion of Surrey Metro Savings' financial results is included in the Management's Discussion and Analysis section.

Overview

The financial services industry worldwide is going through wholesale change. One of the major changes taking place is the consolidation of the industry. Banks and other financial institutions are merging to create larger and more imposing organizations. One of the main factors driving this phenomenon is the cost of future technology necessary to provide all the delivery channels dictated by the customer. To be affordable, this cost must be spread over larger asset bases, thus necessitating mergers.

The public has become reliant on the new delivery channels provided to them by the banking industry. The world has literally been wired by the industry for the benefit and convenience of the customer. Your ABM (Automated Banking Machine) card will access cash anywhere from a remote UK village to Hong Kong. From the debit card to the telephone and the personal computer, the industry has come a long way in making the financial life of its customers easier. This technology has been, and will continue to be, extremely expensive. As the industry works hard to expand and improve its delivery channels, so too does Surrey Metro Savings.

Surrey Metro Savings in the Industry

In 1997, the Company concentrated its efforts on the challenge to satisfactorily deliver products and services to its customers, while delivering profits necessary to pay dividends, produce capital for future growth, and produce above average returns for the shareholder.

Whatever changes we must make to respond to the challenge of competition, branch banking will continue to be a vital delivery channel in our business and our success. As more and more transactional

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banking business is done out of the branch through electronics and the telephone, we foresee that the role of the branch over the next ten years will evolve away from a transaction centre into a consultative sales centre. Branches, in whatever configuration they remain, will always be our most expensive channel of delivery. Therefore, out of necessity, they will become the venue for the highest value-added transactions.

Our branch network did not expand in 1997. We did however make some major renovations to two of our facilities. The Ocean Park Branch, which is 20 years old, was expanded and completely renovated, in a building owned by the Credit Union. Cloverdale, our oldest branch, was relocated into a new, free-standing facility, which is part of the renovated Clover Square Mall in Cloverdale. Clover Square has been our home for more than forty years.

Because of the cost of branch banking, Surrey Metro Savings is largely focusing its energies on alternative, less expensive means of delivering its products and services to its customers. These channels are also the ones most preferred by our customers due to their convenience.

The ABM was launched in the 1970's and has become, over a period of nearly thirty years, a trusted and convenient way for customers to access funds, make deposits, pay bills, and transfer money between accounts. Because the financial industry has collaborated on computer switches, these ABM activities can be performed down the street or around the world. Surrey Metro Savings has 31 ABMs and in the last three years has replaced them all with brand new models. To provide our customers access to their money throughout the world, we are members of all required national and international ABM network switches. We now complete more than three million ABM transactions annually.

The ABM card is also the customers' debit card. This function allows Surrey Metro Savings' customers to make purchases electronically, replacing cheques, a paper-based mode of payment which is quickly becoming dated and cumbersome technology. Surrey Metro Savings will process over four million debit transactions in 1998, exceeding the number of chequing transactions by 30%. Along with the debit card, Surrey Metro Savings issues the Surrey Metro Savings VISA card which allows our customers to make purchases and access cash at VISA ABMs anywhere in the world. The Visa international network is the largest credit card organization in the world, with total worldwide volume of US$1 trillion. The ABM, debit, and credit cards help us extend the reach of our branches by providing our customers with more ways to access our banking services.

In our industry, the fastest growing channel of delivery is the Call Centre. Customers are comfortable with the technology; it provides fast and convenient service and for Surrey Metro Savings it is efficient and competitive. Our Call Centre was launched in late 1995. The Call Centre is now running six days a week, twelve hours a day. It will receive over half a million inbound calls, and place over 300,000 outbound calls in 1998. The Centre allows our customers to perform many of their banking needs from their home or office, or wherever they may be. This facility will be expanded in 1998 to allow us to deliver more products, such as loans and insurance.

Surrey Metro Savings was the second financial institution in Canada to offer automated telephone banking. This automated service, Touch Tone Teller, allows our customers to perform bill payments, transfer between accounts, make loan payments, and obtain account and interest rate information 24 hours a day, 7 days a week from the convenience of any touch tone phone. This service continues to grow every month. We will process over two million calls through Touch Tone Teller in 1998.

Surrey Metro Savings has recently replaced its web site with an entirely new site. This new site is graphics-based and provides a very friendly user interface, allowing for easier web site navigation. Our site provides customers with up-to-date rate and product information, including various loan and deposit

calculators. It has easy e-mail links with Surrey Metro Savings and its insurance subsidiary, Metro Insurance Services Ltd., for financial planning information and insurance quotes. Our new site contains an employment page, and has built-in links to other financial institutions such as mutual fund companies that we represent.

In 1998, Surrey Metro Savings plans to take its web site and Touch Tone Teller one step further by introducing PC Banking. This channel of delivery will provide banking access from the home or office and will appeal to a growing number of customers who have personal computers linked to the Internet, and wish a greater degree of banking sophistication. Although this new service will initially appeal to less than twenty percent of our customers, we believe it will become a channel of choice in the future, along with the Call Centre.

A discussion on delivery channels must end where it started, at the branches. A growing number of our customers increasingly want help with their financial and investment planning. To this end, Metro Insurance Services Ltd. has increased the number of full-time financial planners. These individuals are fully licensed, highly experienced and can offer our customers advice and access to any suitable investment desired. Along with the planners, Surrey Metro Savings has licensed staff at each branch who are qualified to sell a variety of mutual funds.

Surrey Metro Savings continues to develop a strong sales and service culture throughout its organization. We believe this is the only way to ensure that our customers receive extraordinary service, and that we fulfill every needs-based opportunity presented by a customer or prospect. Sales and service classroom training is enhanced through one-on-one coaching on the job. For those customers who demand more attention because of their financial position, we have created the position of Personal Financial Manager, a program which has proven very successful with this tier of customers.

Community Involvement

Surrey Metro Savings donated $165,000 through its Community Involvement Fund to more than 32 organizations in 1997. The fund supports various charities, hospitals, sports teams, cultural societies, community service groups, and high school scholarships for post secondary education.

The Company also has a long history of support to the United Way, having raised over $500,000 since 1990. In 1997, employees of Surrey Metro Savings contributed $78,000, and with the corporate donation of $22,000, we were delighted to present a cheque for $100,000 to the United Way. The Company also won the United Way's Spirit Award for the third consecutive year for one of the best employee campaigns in the Lower Mainland. Besides the Community Involvement Fund, the Company and its employees, provide sponsorship of community events through various marketing and communications initiatives. These include the Run For Health and the Arts Club Theatre's Surrey Series.

Board of Directors

Our Directors continue to play a vital role in shaping policy and ensuring that we never lose sight of our customers, employees, and shareholders.

In 1997, three Directors stepped down from the Credit Union's nine-member Board. After serving his maximum tenure as stipulated by the Company's own Rules, Tom Kirstein stepped down at the conclusion of the May 5 Annual General Meeting. During his nine years, Mr. Kirstein had served on

Surrey Metro Savings has been a vocal advocate for consolidation of the credit union system for ten years and continues to believe that consolidation should be an important part of Surrey Metro Savings short-term and long-term strategies.

virtually all of the Board's committees, including serving three years as Chairman, and leading the Company through many of its significant achievements. Adrienne MacLaughlin and Gurmant Grewal, both elected to the Board in 1994, did not stand for re-election. Mrs. MacLaughlin retired to the east coast of Canada, and Mr. Grewal moved on to federal politics. New Directors elected to the Board were Rodney Bergen, a tax consultant and President of ROI Management Systems Inc.; Amber Goddyn, a Notary Public; and Michael McCartney, partner in the accounting firm Bouchard and Co. The addition of these three new Directors brings fresh thinking, new approaches, strong backgrounds, experience, and skill sets to the Board.

Looking Ahead

As a member of the Canadian financial services industry we continue to be puzzled at the criticism levied against our business by the Canadian public. The industry in Canada earns in the range of .5 to .7 of 1% on its assets out of which it must pay dividends to its shareholders, and provide the capital necessary to finance future growth. Canada enjoys a solid and well managed financial industry, one which the Canadian public should be proud of.

As previously mentioned, the industry is undergoing rapid consolidation. The industry is grappling with the challenge of providing an increasing array of products and services, supported by modern and costly technology, while ensuring profitability.

Surrey Metro Savings has been a vocal advocate for consolidation of the credit union system for ten years, and continues to believe that consolidation should be an important part of Surrey Metro Savings' short-term and long-term strategies. We believe, because of the relative size of credit unions, that consolidation of credit unions is one way to assist its competitiveness in the future. In BC, we have 97 credit unions with a combined asset base of approximately $20.4 billion, with 6,722 staff and 812 directors. We find it difficult to imagine that the present structure of the credit union system in BC will serve our customers well in the highly competitive years ahead.

Surrey Metro Savings will strive to offer all primary delivery channels available in banking. We believe our customers have the right to pick and choose the channels they see fit. Some will be electronic, some personal, and some face-to-face. In order to fulfill this desire, and to generally retain our competitiveness, we believe it is imperative for this organization to get larger.

We believe we know what the future holds: this business will be tougher, we will work harder, consolidation will speed up, and the capital markets will get more demanding. And, we will be called upon to do more with less as we look at ways to reduce costs and become more efficient.

The employees of Surrey Metro Savings have the attitude, will, experience, and ability to do whatever is necessary to remain a highly viable alternative to the large Canadian banks.

H.A. (Bert) Miles
Chairman of the Board

Lloyd M. Craig
President and Chief Executive Officer

Call Centre

Officially opened in December 1995, Surrey Metro Savings' Call Centre has proven to be an invaluable service for customers and a major initiative for the Company as the growth of technology and its impact is felt within the financial services industry.

Using one central location to handle incoming customer telephone calls, the Call Centre provides an important channel in the delivery of personal service that customers have come to count on at Surrey Metro Savings. In addition to providing the method for better managing customer inquiries through such features as pop-up screens with customer information — saving customers time by not having to repeat information when transferred between departments — the Call Centre provides key opportunities for building business relationships.

The Call Centre reflects the changing standard of banking. The Centre is an invaluable service for customers and represents a significant investment for Surrey Metro Savings. This investment, to ensure the development of a first-class Call Centre operation, has proven to be successful. The Call Centre continues to be an example of our commitment to growth, innovation and profitability. Today, Call Centres represent the fastest growing method of banking for many customers.

To stay competitive, we are required to go above and beyond in meeting all of our customers' needs. The financial services industry as a whole is using technology to provide alternative methods of delivery for banking services. Changes in customers' lifestyles fuel the need for access to banking information to be "convenience-driven".

Since all branches came on-line in July 1996, an average of 39,000 calls are received at the Call Centre every month. The calls cover a broad range of customer inquiries — everything from branch hours and balances to requests for advice and lending information. Furthermore, the Call Centre initiated 250,000 outbound calls last year, focusing on telemarketing and customer outreach campaigns.

There is every indication that customer usage of the Call Centre will continue to grow. In addition to the Call Centre, Surrey Metro Savings continues to offer customers the Touch Tone Teller system, an automated source of information and method to conduct standard banking transactions. The Touch Tone Teller system remains an early example of our commitment to technology: Surrey Metro Savings was the second financial institution in Canada to offer telephone banking and the first to offer bill payment by telephone.

In 1998, the Call Centre will expand and enhance the delivery of our services by providing complete insurance and lending products. Providing customers access to our staff and services through the Call Centre, clearly demonstrates Surrey Metro Savings' intention to harness technology to the benefit of company growth and customer service.

call centre

building for today with an eye to tomorrow

The Call Centre reflects the changing standard of banking. The Centre is an invaluable service for customers and represents a significant investment for Surrey Metro Savings.

Surrey Metro Savings

PC Banking Commitment

Surrey Metro Savings has always been aware of the need to provide convenient customer access to the Company's banking products. In 1983, Automated Banking Machines (ABMs) were installed. In 1989, telephone banking with our Touch Tone Teller™ product was introduced. And again, Surrey Metro Savings led the way with the opening of a state-of-the-art Call Centre in 1995.

In 1998, Surrey Metro Savings will reaffirm this service commitment and introduce PC Banking to its complement of technologically-based methods of delivery. This will bring PC home banking to the growing number of customers who have home-based personal computers with modem capability. While the statistics are varied, it is estimated that approximately one quarter of all customers have this capability and will enjoy this method of banking.

As technology continues to play a vital role in developing and changing the financial services industry, Surrey Metro Savings is committed to PC Banking, taking convenience to the next level.

In defining the needs of our customers, we find two distinct groups with very different demands: some prefer to use the branch network while others are more self-service oriented, preferring to conduct transactions through the ABM and telephone services. Surrey Metro Savings is committed to serving both segments of our customer base, providing the means for customers to choose how they access their financial information.

In addition to delivery channels such as in-branch banking, telephone banking, ABMs, and Call Centre service, Surrey Metro Savings will offer PC Banking. Through a personal computer, customers can access their bank accounts at their convenience, 24 hours a day.

PC Banking, through a user-friendly interface, will deliver all the convenience of telephone banking in visual format. Routine transactions such as balance inquiries, transfers between accounts and bill payments will be accomplished on a personal computer with a mouse and keyboard. In addition, account information may be downloaded into Personal Financial Management (PFM) software products, such as Microsoft Money™ and Intuit Quicken™ for further analysis enabling greater money management for our customers.

PC Banking and the flexibility it provides will be an exciting addition to Surrey Metro Savings' current line of electronic services.

building for today with an eye to tomorrow

As technology continues to play a vital role in developing and changing the financial services industry, Surrey Metro Savings is committed to PC Banking, taking convenience to the next level.

Surrey Metro Savings

Wealth Management

Competition is the result of the pressure to adapt and keep pace in an environment of constant change within the organization and the industry.

With large segments of the population aging, particularly as the baby boom generation move into their saving years, customers are looking more to financial institutions to provide advice, counsel and support. By recognizing the need to help our customers meet their individual financial goals, Surrey Metro Savings has developed an approach for wealth management.

Financial Planners and Insurance Consultants enable Surrey Metro Savings to provide complete financial advice. Mutual funds, retirement planning, and insurance services are offered to enhance the wealth management of our customers. Focusing on wealth management is a way of showing customers that we are not only meeting their needs, but anticipating them. Today's finances are more complex, people want advice not simply on basic banking but on saving, investments, and obtaining the greatest return from their hard-earned money. Advances in technology have meant that branch staff are freed from the time-consuming and routine tasks of banking and have more time to devote to personalized sales and service.

In response to the demand for more capital market products by our customers, Surrey Metro Savings offers a wide range of mutual fund products. Whether they are ethical funds and third-party mutual funds offered in the branches or additional third-party mutual funds offered through accredited Financial Planners, Surrey Metro Savings understands the need for choice.

A relationship banking program that the Company rolled out in 1996 completed its first full year of operation in 1997. The objective was to establish and develop ongoing relationships with our top retail customers at the branch level. The Personal Financial Manager (PFM) program was met with great reviews from customers — customers who are looking to us to be a partner in their wealth management. The PFM program matches one employee at each branch with selected customer portfolios, providing important continuity and personal attention on the more complex transactions of our best customers.

It is the desire of Surrey Metro Savings to be a company that is responsive, flexible, competitive and focused on customer service. The innovative ways in which we grow with our customers, recognizing and meeting their needs, is the key to our continued growth and prosperity.

wealth management

building for today with an eye to tomorrow

Financial Planners and Insurance Consultants enable Surrey Metro Savings to provide complete financial advice. Mutual funds, retirement planning, and insurance services enhance our customers' wealth management.

Commitment to Service

Surrey Metro Savings

In our first 50 years, Surrey Metro Savings established itself as a successful company in the Fraser Valley. The ability to adapt and change with market forces, our focus on profitable and sound business decisions and growth strategies, and our responsibility to our shareholders have all played a vital role in that success.

Even more influential than these factors is our strong commitment to service to the people and communities that we serve. From our humble beginnings in 1947, Surrey Metro Savings has been known as a partner in the community. This partnership has translated into real and valued contributions of time and funding to worthy projects in the area and has provided substance behind customer service.

Even with the myriad of technological options available, many customers still prefer "face-to-face" banking. This is especially true of more involved transactions such as mortgages, registered retirement savings plans, and mutual funds. Surrey Metro Savings recognizes that branches remain a vital part of our business. Whether at a branch, over the telephone or on a personal computer, customer service will always be the most important part of our business. There is a commitment to serve customers at the very highest level.

Customer surveys tell us that continuity of staff is also important. To that end, Surrey Metro Savings is dedicated to providing the necessary training and development to ensure that our employees are fully equipped to be the best that they can be. The tremendous growth opportunities in the Fraser Valley is taken advantage of with appropriate investments to existing branches and technologies.

The Company's Cloverdale Branch, formerly located in the old Clover Square Mall, was relocated to a free-standing site when the mall was remodeled. The new branch increases visibility and features a number of private offices in addition to the regular teller stations. Customers have told us they appreciate the privacy of a closed-door office when discussing complex financial transactions. And as customers are looking to Surrey Metro Savings for assistance in their wealth management, the rebuilding of Cloverdale branch can be seen as an example of our responsiveness.

The branch also features in-branch ABMs and a drive-thru ABM as well. Coincidentally, the new Cloverdale branch is now situated almost precisely on the site of the original Surrey Metro Savings branch.

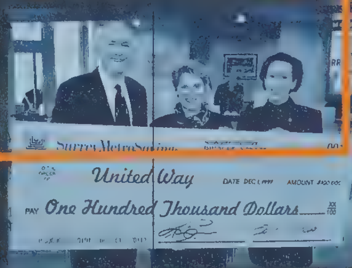
A number of initiatives have been undertaken to ensure that our commitment to service is as real and current now as it was when we were established. In a company-wide review, employees came together to assist the Company in re-thinking the way it operates. This process, called Business Process Redesign, resulted in many improvements in branch efficiency and effectiveness, allowing our employees to spend more time providing personal attention to customers.

As Surrey Metro Savings approaches its first year of operation after the 50 year mark, we look forward to maintaining a spirit of innovation and competitiveness that will ensure continued success.

friendly service

building for today with an eye to tomorrow

Even with the myriad of technological options available, many customers still prefer "face-to-face" banking. Surrey Metro Savings recognizes that branches remain a vital part of our business.



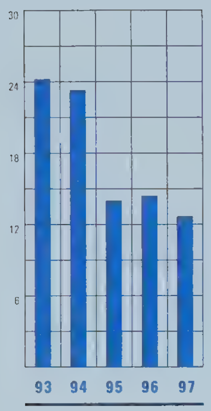
Performance Against Objectives

	Objectives	*Performance*
Deposit Growth	Increase deposits by $116 million.	$104 million
Loan Growth	Increase total loan portfolio by $165 million.	$154 million*
Capital	Attain BIS capital level of 10.0% of risk-weighted assets.	10.40%
Profitability	Achieve $9.2 million net income after tax.	$8.9 million
Return on Average Assets	Achieve an after tax return of 0.49% on average assets.	0.47%
Return on Average Equity	Achieve return on average equity of 13.30%.	12.70%
Non-Interest Expenses	Total non-interest expenses (including subsidiaries) to be no greater than 2.44% of average assets.	2.47%
Earnings Per Non-Voting Share	Achieve earnings per share of $1.64.	$1.57

** prior to sale of $33 million*

Financial Review

Management's Discussion and Analysis of Financial Condition and Results of Operations



Return on Average Equity
in percent

ROAE declines as flat earnings are divided by increasing equity levels.

This section of the Annual Report contains details of the operations and financial condition of Surrey Metro Savings (SMS). It also provides a discussion of how the Company manages credit, liquidity, and interest rate risks, as well as information on its capital structure.

Introduction

SMS successfully competes with banks, trust companies, credit unions, and other financial institutions in its market area by providing a high level of service and product quality. Its business focus is on attracting retail savings deposits from customers in the Fraser Valley region of British Columbia and using this deposit base to fund a loan portfolio comprised primarily of residential first mortgage loans.

The Fraser Valley region is one of the fastest growing areas in Canada and SMS is a well-established financial institution with a 50-year history of serving this region. The population growth in the Fraser Valley and SMS's ability to compete successfully with other financial institutions have enabled SMS to achieve asset growth and earnings without deviating from its conservative strategy of funding residential first mortgage loans primarily with retail deposits.

Overview of 1997

Net income for 1997 was $8.9 million, down 2.5% from $9.1 million achieved in 1996. Earnings per share for 1997 were $1.57, compared with $1.61 in 1996. Return on average assets was 0.47%, compared to 0.51% in 1996. Return on average equity was 12.70%, compared with 14.42% for 1996.

The number of Preferred Shares (with a $1 par value, and required by statute for membership) was 7,795,500 as at December 31, 1997. As prescribed by the Canadian Institute of Chartered Accountants, these Preferred Shares are now classified as liabilities. However, they remain part of SMS's capital calculations, as permitted by the Superintendent of Financial Institutions of British Columbia. The number of Non-Voting Shares outstanding as at December 31, 1997 was 5,663,672.

Assets grew in 1997 by 6.7%, compared with 5.5% for 1996. The higher rate of asset growth was largely brought about by low interest rates. This asset growth was achieved after the sale of $33 million in residential mortgages and the liquidation of a $20 million bond portfolio, the proceeds of which were applied against borrowings. Total assets at year-end were $1.9 billion, up from $1.8 billion in 1996. Total loans were $1.7 billion, up 7.7% from $1.5 billion in 1996. Total deposits were $1.7 billion, an increase of 6.4% from $1.6 billion in 1996. Net interest income was $43.9 million, up from $43.5 million in 1996.

Other income was $15.1 million versus $13.2 million for the previous year. Non-interest expenses increased to $46.1 million from $43.6 million for 1996.

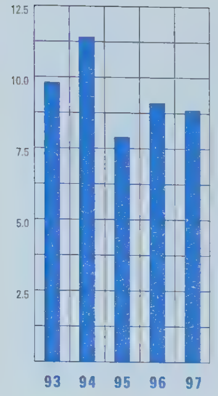
Net Interest Income

Interest income is the major source of revenue for SMS. In 1997, the Company earned income of $127.0 million in interest from borrowers on their loans and from cash resources, securities, and other. This represents a decrease of $11.6 million over 1996. Interest expense, which represents amounts paid by SMS as interest on customer deposits and corporate borrowings, totalled $83.1 million, a decrease of $12.0 million over 1996. Both decreases reflect the lower interest rate environment in 1997.

Net interest income represents the difference between interest income and interest expense. Net interest income for 1997 was $43.9 million, compared with $43.5 million for 1996. Net interest income was negatively impacted by the low interest rate environment in 1997. Low interest rates made it difficult to encourage customers to keep their money in deposits and not seek alternative higher yielding investments, such as mutual funds. This increased competition for deposits, as well as employing costlier sources of alternative funding, such as borrowings, resulted in funding costs not decreasing to the same extent as loan yields. Included in net interest income in 1997 was a $0.75 million gain achieved through the sale of bonds. This compared to a similar gain of $1.3 million in 1996. Net interest income, as a percentage of average assets, was 2.35% for 1997, compared with 2.45% for 1996.

Analysis of Net Interest Income

in thousands of dollars	1997 Average Balance	1997 Mix (%)	1997 Interest	1997 Interest Rate	1996 Average Balance	1996 Mix (%)	1996 Interest	1996 Interest Rate
Cash Resources and Securities	**212,802**	**11**	**9,370**	**4.40**	230,596	13	15,593	6.76
Loans								
Residential	**1,246,952**	**67**	**90,241**	**7.24**	1,183,176	66	95,273	8.05
Commercial	**198,916**	**11**	**14,674**	**7.38**	173,574	10	14,407	8.30
Personal	**69,861**	**4**	**5,344**	**7.65**	65,770	4	6,042	9.19
Lines of Credit	**104,581**	**5**	**7,344**	**7.02**	87,535	5	7,247	8.28
Total Loans	**1,620,310**	**87**	**117,603**	**7.26**	1,510,055	85	122,969	8.14
Other Assets	**37,014**	**2**	**0**	**0.00**	36,134	2	0	0.00
Total	**1,870,126**	**100**	**126,973**	**6.79**	1,776,785	100	138,562	7.80
Deposits								
Demand	**313,793**	**17**	**2,637**	**0.84**	306,055	17	4,473	1.46
Term	**780,563**	**42**	**42,577**	**5.45**	754,815	42	49,227	6.52
RRSP	**517,392**	**27**	**28,719**	**5.55**	492,863	28	31,727	6.44
Total Deposits	**1,611,748**	**86**	**73,933**	**4.59**	1,553,733	87	85,427	5.49
Borrowings	**153,497**	**8**	**8,245**	**5.37**	136,076	8	9,452	6.95
Subordinated Notes	**10,000**	**1**	**906**	**8.98**	2,419	0	220	8.98
Other Liabilities	**25,012**	**1**	**0**	**0.00**	20,909	1	0	0.00
Shareholders' Equity	**69,869**	**4**	**0**	**0.00**	63,648	4	0	0.00
Total	**1,870,126**	**100**	**83,084**	**4.44**	1,776,785	100	95,099	5.35
Net Interest Income			**43,889**	**2.35**			43,463	2.45



Net Income
in millions of dollars

Decreased real estate activity and competition for deposits led to flat net income.

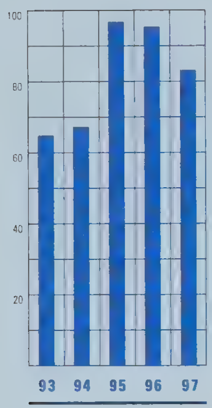
Other Income

Other income is all income that is not interest related. This includes such items as service charges for retail banking services, lending fees, insurance commissions generated by SMS's insurance company, rental income from SMS-owned properties, creditor insurance commissions, foreign exchange income, Visa fees, and mutual fund commissions. SMS practices a "user pay" policy as much as possible, especially in relation to its deposit accounts and financial services, and reviews its lending fees and service charges annually to ensure adequate returns while maintaining market competitiveness. SMS adjusted some of its service charges during 1997. Other income grew by 13.8% during 1997 to $15.1 million, compared to $13.2 million in 1996.

Non-Interest Expenses

Non-interest expenses represent all costs that are not interest related, excluding provisions for credit losses and income taxes. It includes staff salaries and benefits, occupancy, data processing, marketing, deposit insurance assessments, Credit Union Central of British Columbia (CUC) dues, and provincial capital taxes, among other items. Total non-interest expenses for 1997 were $46.1 million, a $2.6 million or 5.9% increase over 1996. Non-interest expenses represented 2.47% of average assets, compared with 2.45% of average assets in 1996.

Staffing costs grew by $1.0 million or 4.5%. The increase included sales incentives and individual and team bonuses. The incentives program is reviewed by



Interest Expense
in millions of dollars

Very low interest rates and shortening deposit terms resulted in reduced deposit costs.

the board of directors on a regular basis and can be revised to reflect prevailing economic conditions.

Occupancy costs increased by $0.4 million or 6.6% over 1996. This increase reflected a full year's occupancy in the Call Centre and a major renovation of SMS's Ocean Park Branch. General expenses increased by $1.2 million, a 7.5% increase over 1996. This increase reflected aggressive marketing campaigns and professional consulting fees.

Capital Expenditures/Premises and Equipment

In 1997, Cloverdale Branch moved into a new facility. The increase in capital expenditures reflects this move and other routine capital replacements.

Years Ended December 31 / in thousands of dollars	**1997**	1996
Building renovations and improvements	**563**	423
Leasehold improvements	**549**	106
Computer equipment/software	**2,689**	2,910
Furniture and equipment	**1,057**	162
Total	**4,858**	3,601

(Does not include asset disposals.)

Risk Management

Management of risk is an ongoing and continuous process, with the goal of achieving consistent optimal earnings over the long term. All of SMS's investment and loan policies, including risk management, are reviewed annually by the board of directors and any changes to previously approved policies are reviewed for prudence by the Superintendent of Financial Institutions of British Columbia. The board of directors also reviews monthly reports on liquidity, interest rate risk, credit loss provisions, delinquent and impaired loans, regulatory capital, and financial performance. There are three principal areas of risk which SMS monitors and manages: interest rate risk, credit risk, and liquidity/investment risk.

Interest Rate Risk/Matching Assets and Liabilities

Interest rate risk represents the effect movements in interest rates can have on SMS's financial position. Interest rate risk arises when there is a difference in the amount of assets and liabilities that mature within a similar period.

While the high proportion of residential first-mortgages provides a stable asset base, like any other financial institution, SMS's annual profitability depends largely on its ability to manage the maturities and yields of its assets against the maturities and costs of its liabilities.

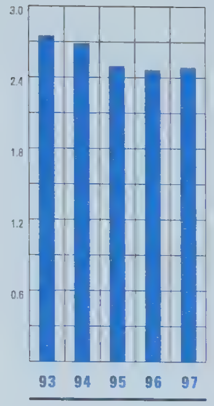
SMS closely manages its interest rate risk through various strategies designed to optimize the return to SMS of differences between deposit and loan rates for different maturities. An asset and liability management committee (ALCo) comprised of the chief executive officer, senior vice presidents, vice presidents, and other senior managers, meets monthly to review and monitor asset and liability-related activities and initiate policy changes where necessary. A subcommittee of the group meets weekly.

The differentials shown in the table on the next page for different maturities can change from one year to the next and to some extent are dependent on the interest rate expectations held by the mortgage, loan, and deposit customers of SMS. As previously noted, this information is monitored by management on a weekly basis to ensure early identification of any trends that are developing, or any differentials that are becoming materially large. Through computer modelling techniques, SMS determines its interest rate risk on a monthly basis. The modelling determines the effect on pretax income of an immediate 1% rise in rates, as well as a gradual 3% rise, over the next 12 months. If the interest rate risk is approaching a level above policy guidelines, the largest differentials are reduced through either conventional means, such as deposit drives and the sale of mortgages, or so-called synthetic means employing derivative instruments such as interest rate swaps.

The table on the following page shows the matching of maturities of the assets and liabilities of SMS at December 31, 1997, as well as those at December 31, 1996.

Years Ended			1997			1996
in thousands of dollars	**Assets**	**Liabilities**	**Differential**	Assets	Liabilities	Differential
Interest sensitive:						
maturing within 1 year	**804,984**	**1,115,735[2]**	**310,751**	766,509	1,116,714[1]	350,205
Maturing between:						
1-2 years	**198,202**	**173,213**	**(24,989)**	189,052	183,121[2]	(5,931)
2-3 years	**409,331**	**164,694[2]**	**(244,637)**	222,636	142,708[2]	(79,928)
3-4 years	**203,127**	**170,171[2]**	**(32,956)**	372,447	103,485	(268,962)
4-5 years	**258,129**	**179,938**	**(78,191)**	197,068	138,996	(58,072)
6-10 years	**13,470**	**10,000**	**(3,470)**	15,099	10,000	(5,099)
Non-interest bearing items[3]	**42,134**	**115,626**	**73,492**	45,356	113,143	67,787
	1,929,377	**1,929,377**	**—**	1,808,167	1,808,167	—

[1] Includes the effect of $80,000,000 in interest rate swaps.
[2] Includes the effect of $40,000,000 in interest rate swaps.
[3] Assets include cash, accrued interest receivable, premises and equipment and other items. Liabilities include accrued interest payable and other items.



Non-Interest Expenses to Average Asset Ratio
expressed as a percentage

Non-Interest expense as a percentage of average assets increased from 2.45% to 2.47%.

Rapidly rising interest rates can negatively impact SMS's net interest income as a large portion of SMS's liabilities will reprice before many of its assets can do the same. Most financial institutions tend to deem a prudent level of asset/liability mismatching to be necessary in order to improve profitability. The challenge is to find the level of mismatch that will optimize a financial institution's net interest income without unduly increasing risk in the event interest rates were to increase rapidly.

SMS's level of interest rate risk increased during the year due to historically low interest rates driving depositors into short terms while borrowers chose long terms.

SMS installed a new Windows-based Asset/Liability Management (ALM) modelling system in 1997. It consists of two parts, a database warehouse and actual ALM software that retrieves its information from the warehouse. SMS expects the new system to fully replace the old system by the end of the first quarter of 1998. The new system allows for leading edge interest rate risk analysis, including rate shocks, gap and market value analysis in present and future periods, as well as running stochastic models which report interest rate risk information on a statistical basis.

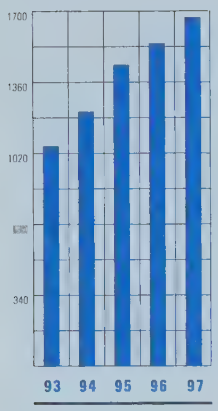
Credit Risk

SMS's system for controlling the risk of borrowers defaulting on loan obligations is based upon strict adherence to clearly defined credit policies and credit approval procedures. Authority for loan approval to specified limits is granted to officers within each branch by the president and chief executive officer within the guidelines reviewed annually by the board of directors. Loan approval limits are established based upon the experience and qualifications of the individuals involved. If a proposed loan is beyond the lending limit prescribed for branch management, it is forwarded, to the manager, retail credit, or the vice president, credit, depending on the size of the loan. If a loan is beyond the internal lending limit prescribed for the vice president, credit, it is submitted to the loans committee (comprised of senior lending managers) and either approved at this level or further recommended for approval to the management credit committee (comprised of the chief executive officer and other executive officers).

All new lending in each branch is reviewed at least annually by a credit inspector to ensure adherence to policy guidelines and general credit quality. Loans requiring collection are removed from the branch level and centralized for further follow-up in the Retail Credit Department.

Liquidity/Investment Risk

As required by the Financial Institutions Act of British Columbia (FIA), 10% of SMS's total deposits and borrowings are held at CUC in a liquidity portfolio comprised of deposits with maturities ranging from overnight to one year. The CUC deposits provide yields similar to those of Government of Canada Treasury Bills. In addition to the liquidity portfolio held at CUC, SMS maintains excess liquidity. SMS's goal is to maintain a total liquidity portfolio of 10.5% - 12.5% of total deposits and borrowings. It is management's view that a total liquidity portfolio between 0.5% and 2.5% in excess of that required by the FIA provides a



Total Loans
in millions of dollars

Loan growth was 7.7% after mortgage sales, despite lower real estate activity.

prudent margin of liquidity over the 10% statutory requirement, without unduly impairing SMS's return on assets.

SMS's investment policy specifies the minimum rating, maximum term, and certain single investment exposures for investments made with excess liquidity. In general, excess liquidity is invested in money market instruments that are rated R-1 low or higher and mature in less than one year. At December 31, 1997, SMS's liquidity was 12.2% of deposits and borrowings, as compared to 11.2% in 1996.

Loans

Total loans as at December 31, 1997 were $1.7 billion, compared with $1.5 billion at the previous year-end, an increase of 7.7%.

SMS aggressively competes for, and is a major holder of, residential first-mortgages in the Fraser Valley region. It grants mortgages to individuals according to conventional mortgage-lending standards for residential property. SMS offers closed, fixed-rate mortgages and open, variable-rate and fixed-rate mortgages; written with terms of 6 months to 10 years.

At December 31, 1997, SMS's portfolio of residential mortgage loans totalled $1.3 billion, representing 75.6% of total loans outstanding, compared with total residential mortgage loans of $1.2 billion, which represented 78.8% of the total loans at December 31, 1996. Net growth of mortgage loans over 1996 was 3.5%. SMS approved a total of 2,664 residential mortgages in 1997, and the average mortgage advance was $151,000. There were a total of 10,967 residential mortgages outstanding at December 31, 1997, with an average mortgage balance of $115,000. The above numbers exclude the sale of $33 million in residential mortgages.

Although interest rates reached historical lows, the real estate market in the Fraser Valley region was relatively flat in 1997. According to Statistics Canada, the Fraser Valley still remains one of the fastest growing regions in Canada. Compared with other areas of British Columbia's Lower Mainland, such as Vancouver, Richmond, Burnaby, and the North Shore, the Fraser Valley also continues to offer lower housing prices. Significant numbers of new residents continue to move into the Fraser Valley region. The Greater Vancouver Regional District expects the lower Fraser Valley region to record the highest rate of population growth in the Lower Mainland well into the next century. The availability of undeveloped land has kept average housing costs significantly lower than in other parts of the Lower Mainland, which results in average mortgages being substantially lower. Lower average mortgage advances may reduce the risk to SMS of individual mortgage loan defaults.

Personal loans to customers comprise instalment loans, demand loans, and lines of credit. SMS also offers a Visa credit card through an arrangement with a major Canadian chartered bank. Under the arrangement, SMS does not carry the receivables owing from its credit cardholders but earns a fee based on the total net purchases generated by its credit cardholders, as well as a per card fee.

At December 31, 1997, SMS had a personal loans portfolio of $171.9 million representing 10.3% of total loans outstanding, compared with $147.9 million representing 9.6% of total loans at December 31, 1996. Net growth of personal loans over 1996 was 16.2%.

Commercial lending consists primarily of first-mortgage loans to small and medium-sized businesses for real estate projects in the Lower Mainland region. The types of mortgages offered are similar to residential mortgages, except the maximum term is limited to five years. Although SMS also conducts other forms of commercial lending, these constitute a small portion of the commercial loan portfolio.

At December 31, 1997, SMS's commercial loans portfolio totalled $234.0 million, representing 14.0% of total loans outstanding, compared with $181.0 million, representing 11.7% at December 31, 1996. Net growth of commercial loans was 29.3%. SMS approved 302 commercial loans with a total value of $161.0 million during 1997. The average commercial mortgage advance was $532,000. While many loans were short term and repaid within the year, the growth in commercial loans was primarily due to growth in permanent loans, such as mortgages on apartment buildings. There were a total of 853 commercial loans outstanding at December 31, 1997, with an average advance of $274,000.

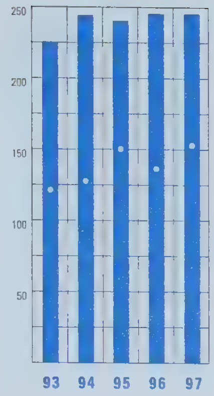
SMS maintains conservative lending policies. The Company holds no foreign loans. SMS's policy limits commercial lending to a maximum of 20% of the Company's total loans portfolio and the maximum loan exposure to any one borrower, to an amount which is the lesser of $8.5 million or 10% of SMS's aggregate share capital, retained earnings and subordinated notes. SMS has no loans outstanding which exceed its internal limit. This limit is included in SMS's internal investment and lending policy which is reviewed annually by the Superintendent of Financial Institutions of British Columbia.

Loan Portfolio

as at December 31, 1997

	Number	Total in millions of dollars	in percent	Average in thousands of dollars
Individuals				
Mortgages				
Conventional	8,217	882	53.0	107
Revenue	655	71	4.3	108
Progressive	131	24	1.4	183
NHA/MICC Insured	1477	211	12.6	143
SMS High-Ratio	487	72	4.3	148
Subtotal Mortgages	10,967	1,260	75.6	115
Other				
PLC (Mortgage Secured)	1,097	51	3.1	47
PLC (Other)	17,738	57	3.4	3
Personal Loans	10,933	64	3.8	6
Subtotal Other	29,768	172	10.3	6
Subtotal Individuals	40,735	1,432	86.0	35
Commercial	853	234	14.1	274
	41,588	1,666	100.0	–
Accrued Interest	–	5	–	–
Total Loan Portfolio	41,588	1,671	–	40

(Before allowance for credit losses.)



Average Residential Sale Price Compared to Average SMS Mortgage Advance
in thousands of dollars

∘ average SMS mortgage advance in the year

Average mortgage advances continue to be well below average sale prices.

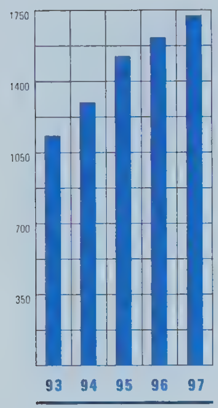
Allowance for Credit Losses

SMS has an established policy of providing an allowance to cover potential credit losses. It is reviewed on an ongoing basis and in cases where potential credit losses are identified, a specific allowance is established. The annual provision for credit losses remained unchanged at $1.2 million. At December 31, 1997, the allowance for credit losses was $3.2 million, representing 0.19% of total loans, compared with $3.0 million or 0.19% of total loans in 1996. These allowances are after loan write-offs of $1.04 million in 1997, compared to $0.68 million in 1996. The increase in write-offs is a reflection of the general economic slowdown in British Columbia, including SMS's trading area.

Asset Quality Coverage

As at December 31, SMS's asset quality coverage was as follows:

in thousands of dollars	**1997**	1996	1995	1994	1993
Total Loans	**1,668,350**	1,548,486	1,444,649	1,221,162	1,056,657
Provision for Credit Losses (PCL)	**1,190**	1,162	600	600	600
Loan Write-Offs	**1,041**	678	421	327	373
Total Allowance	**3,152**	3,003	2,519	2,340	2,067
Impaired Loans	**3,845**	5,003	4,090	617	384
Shareholders' Equity	**73,147**	66,537	59,628	53,836	44,668
in percent					
PCL as % of Total Loans	**0.07**	0.08	0.04	0.05	0.06
Loan Write-Offs as % of Total Loans	**0.06**	0.04	0.03	0.03	0.04
Impaired as % of Total Loans	**0.23**	0.32	0.28	0.05	0.04
Impaired as % of Shareholders' Equity	**5.26**	7.52	6.86	1.15	0.86
Total Allowance as % of Impaired Loans	**81.98**	60.02	61.60	379.30	538.30
Total Allowance as % of Total Loans	**0.19**	0.19	0.17	0.19	0.20



Total Deposits
in millions of dollars

Deposits grew by 6.4% in 1997 compared to 6.3% in 1996.

Securities

In 1994, SMS established a policy to allow it to invest in bonds as an alternative to mortgage investments. The portfolio must consist of bonds with terms to maturity of 1 - 5 years, and have at least an "A grade" rating or better. While $7 million of SMS's bond portfolio matured in 1997, the Company opted to sell the balance of $20 million in the fourth quarter, taking advantage of the prevailing low interest rates. This transaction provided SMS with additional liquidity for its core business.

Deposits

Total deposits as at December 31, 1997 were $1.7 billion, compared with $1.6 billion for the previous year, an increase of 6.4%. Deposit growth was challenging throughout the year due to historically low interest rates.

SMS offers a full range of personal deposit services and products, including chequing accounts, savings accounts, and term deposits. All deposit accounts are in Canadian funds, with the exception of a special United States dollar savings account. SMS also provides special benefit packages on some of its accounts for individuals aged 59 and over or 18 and under. SMS is also active in the registered retirement savings plan (RRSP) market, offering term and variable RRSPs and registered retirement income funds (RRIFs).

At December 31, 1997, total demand deposits, including preferred shares, represented 16.3% of total deposits, compared with 19.2% in the previous year. Term deposits represented 53.2%, compared with 48.5% in 1996, and registered savings plans represented 30.5%, compared with 32.3% in 1996.

SMS is an aggressive competitor for deposits in its market. The low interest rate environment in 1997 resulted in modest RRSP deposit growth as investors opted for mutual funds. The Company continues to develop innovative and competitive marketing strategies for this major deposit drive. In 1997 the registered savings plans portfolio increased by $3.3 million, compared with a $52.0 million increase in 1996.

Term deposits are the most suitable for matching with mortgage lending. The Company continued to be successful throughout 1997 in developing a term portfolio (including registered plans) which represented 81.7% of the total deposit base as at December 31, 1997, compared with 81.2% in 1996.

In 1997 interest rates dropped to the lowest level in 40 years. Deposit growth was very challenging in the face of strong competition from mutual funds, stocks and bonds, and other equities which became increasingly attractive options to many depositors. SMS introduced various deposit products designed to appeal to retail and institutional customers. These efforts were successful in generating in excess of $110 million in new deposits.

SMS continues to develop and offer innovative and flexible deposit products and attractive interest rates in order to remain competitive in the marketplace. SMS also actively markets the family of ethical mutual funds, a group of eight mutual funds owned and managed by the Canadian credit union system. These funds provide SMS customers with another investment option and provide SMS with an alternative source of revenue. SMS also sells a variety of third-party mutual funds, and receives the standard commissions for these sales.

Borrowings

In June 1994, SMS entered into an arrangement with several financial institutions for a $70 million syndicated loan, which the Company subsequently increased to $100 million in 1996. This loan facility is subject to standby fees and may be drawn down at any time. In addition to this facility, SMS maintains a substantial loan facility with CUC. Outstandings under both facilities fluctuated in the normal course of business during the past year. As at year-end, total outstandings amounted to $110 million, up from $100 million in 1996.

Capital

SMS's capital requirements are regulated by the Financial Institutions Commission (FICOM) using the risk-weighted approach developed by the Bank for International Settlements (BIS) in 1988. FICOM established a minimum capital standard based on a ratio of capital-to-risk-weighted assets of 8%. At least 50% of a credit union's capital base for the purpose of meeting the standard

must consist of a core element, known as Tier 1 capital, comprised of non-voting shares, preferred shares, contributed surplus, retained earnings, and deferred income taxes. Secondary capital, known as Tier 2, was reclassified in 1997 and now includes, subordinated notes and a credit union's portion of retained earnings in the Credit Union Deposit Insurance Corporation, CUC, and Stabilization Central Credit Union. A credit union's assets are weighted according to six categories of relative risk ranging from 0% to 150%. Residential mortgages, which form the majority of the assets of SMS, are risk-weighted at 50%.

As at December 31, 1997, SMS had a total capital ratio of 10.4%, unchanged from 1996.

The following tables show the levels of SMS's capital and its risk-weighted assets under the BIS requirements.

Tier 1 and 2 Capital

As at December 31 / in thousands of dollars	**1997**	1996
Tier 1 Capital		
Non-Voting shares	**28**	28
Preferred Shares	**7,795**	7,591
Contributed surplus	**248**	248
Retained earnings [1]	**74,124**	67,612
Equity in subsidiaries	**(1,253)**	(1,351)
Deferred taxes	**(984)**	(568)
	79,958	73,560
Tier 2 Capital		
Subordinated Notes	**10,000**	10,000
Portion of equity in Credit Union Central, CUDIC, and StabCentral [2,3]	**9,331**	7,799
	19,331	17,799
Total Capital	**99,289**	91,359

[1] *Presented on an unconsolidated basis as required under the capital requirements regulation of the FIA for calculating risk-weighted assets.*
[2] *Represents 50% of the total amount of SMS's portion.*
[3] *Previously included under Tier 1 capital, 1996 restated.*

Risk-Weighted Assets

As at December 31	**1997**	1996		**1997**	1996
in thousands of dollars	**Balance Sheet Amount**	Balance Sheet Amount	BIS Risk Weight (%)	**Risk-Weighted Balance**	Risk-Weighted Balance
Cash Resources	**214,912**	186,579	0	—	—
Securities/Commercial Paper	**8,372**	35,333	0-100	**4,186**	13,786
Residential mortgages	**1,033,391**	1,012,209	50	**516,696**	506,104
NHA/MICC mortgages	**206,491**	188,004	0	—	—
High-ratio mortgages	**71,881**	57,081	100	**71,881**	57,081
Personal loans	**121,010**	110,170	0-80	**85,426**	76,126
Commercial loans	**235,577**	181,023	100	**235,577**	181,023
Revenue property	**5,129**	5,043	150	**7,694**	7,564
Other assets/investments	**32,614**	32,725	100	**32,614**	32,725
	1,929,377	1,808,167	—	**954,074**	874,409

in percent	**1997**	1996
Ratio of Capital to Risk-Weighted Assets:		
Tier 1 capital to risk-weighted assets	**8.4**	8.4
Tier 2 capital to risk-weighted assets	**2.0**	2.0
Total capital to risk-weighted assets	**10.4**	10.4

Year 2000 Project

The year 2000 is approaching and SMS is working to ensure a smooth transition to the millennium. The Year 2000 challenge is concerned with the fact that computer systems may read "2000" as "1900". SMS is dependent on information technology and as such the board of directors and management have recognized the importance of this issue from a company-wide perspective. SMS's overall strategy encompasses hardware, in-house computer and embedded systems, vendors, customers, and suppliers.

In 1997 SMS began an assessment phase to determine the size and complexity of the problem and detail the magnitude of the effort necessary to address the issues and risks. SMS is identifying resource

needs, time frames, and testing and implementation requirements to eliminate potential impacts. Contingency plans are being developed as part of the Year 2000 project to mitigate risk associated with reliance on external vendors, data exchange, and contractual agreements.

All initiatives are progressing on schedule, with a targeted completion date by the middle of 1999. SMS is providing financial resources in the range of $500,000 to $1,000,000 to this project, the actual costs of which will either be expensed as incurred or deferred and amortized pursuant to generally accepted accounting principles. SMS has the necessary resources and is dedicated in its efforts to address all Year 2000 related issues.

Outlook

Loans and Deposits

Short-term interest rates rose by 0.50 - 1.0% in the fourth quarter of 1997. This rise has affected 1-5 year mortgage rates by 0.20 - 0.30 %, and may be the reason for a noticeable slowdown in the number of residential transactions across British Columbia, including SMS's primary trading area. It is anticipated that there will be a modest recovery in the second half of 1998, which should generate reasonable loan growth.

Low interest rates will continue to make deposit growth very challenging in 1998 as customers and investors look to higher yielding products such as mutual funds and equities. SMS intends to continue to pursue retail and institutional deposits in 1998 as well as mortgage sales to fund its loan growth. SMS also intends to place more emphasis on the sale of third-party mutual funds in 1998, enhancing its other income through commissions.

Liquidity

SMS is targeting liquidity to remain in the range of 10.5% to 12.5% of deposits plus borrowings. In management's opinion, this margin above the 10.0% statutory minimum, together with the ability of SMS to access its syndicated loan facility and to sell mortgages, will provide adequate liquidity for normal operations.

Income

The flat yield curve that is presently in the Canadian money market would typically result in negative consequences for SMS's net interest income. This is because SMS tends to take on calculated levels of interest rate risk in order to widen average spreads and thus optimize profitability. This is done by funding long-term assets with short-term liabilities. With a flat yield curve there is little income benefit from taking on additional interest rate risk. The present risk-free matched spreads are over 2.0%, considerably higher then the historic range of 1.0 - 1.5%. This should help SMS maintain net interest income levels throughout 1998 without having to rely on additional interest rate risk. Net interest income levels expected in 1998 assume relatively stable interest rates. However, if interest rates rise, net interest income is likely to be reduced due to SMS's present modest interest rate risk exposure.

Provisions for credit losses in 1998 are not expected to change significantly from 1997. Non-interest expenses are expected to increase approximately 4.0%.

Current income tax legislation provides that corporations are taxed at rates which reach as high as 45.6%. Credit unions can reduce normal corporate income tax rates through a special income tax rate reduction which is based upon the relationship between the level of deposits and accumulated pre-tax earnings. Due to the fairly low deposit growth rate expected in 1998, the Company may not receive this tax rate reduction on portions of its 1998 taxable income, and accordingly, is increasing its provision for income taxes from 25% to approximately 34% for fiscal 1998. In the event that deposit growth returns to historic levels SMS will be able to reduce its income tax rate from the projected rate of 34%.

The anticipated interest rate environment, SMS's continued commitment to cost containment, and the projected deposit growth, should provide for an increase in net income in 1998.

Subsequent Event

Subsequent to year-end, SMS received approval to proceed with a normal course issuer bid through the facilities of The Toronto Stock Exchange. The Company intends to repurchase up to 283,183 non-voting shares, representing 5.0% of its 5.7 million outstanding non-voting shares. Transactions will be executed at market prices in accordance with the polices and procedures applicable to normal course issuer bids. This initiative is intended to enhance the Company's long-term value for its shareholders.

Management's Responsibility

The consolidated financial statements and all other information contained in the Annual Report are the responsibility of management and have been approved by the Board of Directors. The consolidated financial statements have been prepared by management in accordance with the requirements of the Credit Union Incorporation Act and appropriate generally accepted accounting principles in Canada, and include amounts based on informed judgements and estimates of the expected effects of current events and transactions. Financial information presented elsewhere in this Annual Report is consistent with that in the consolidated financial statements.

In meeting its responsibility for the reliability of financial data, management relies on comprehensive internal accounting, operating and system controls. Controls include an organizational structure providing for effective segregation of responsibilities, delegation of authority and personal accountability, and careful selection and training of personnel; the application of accounting and administrative policies and procedures necessary to ensure adequate internal control over transactions, assets and records, as well as a continued program of extensive internal audits. These controls are designed to provide reasonable assurance that financial records are reliable for preparing financial statements and maintaining accountability for assets, and that assets are safeguarded against unauthorized use or disposition. The Board of Directors has appointed an Audit Committee, comprised of three Directors, to review with management and auditors the annual financial statements prior to submission to the Board of Directors for final approval.

Doane Raymond has been appointed by the membership as independent auditors to examine and report on the consolidated financial statements and their report appears below. They have had full and free access to the internal audit staff and the Audit Committee of the Board.

Lloyd M. Craig
President and Chief Executive Officer

Hermann G. Bessert
Senior Vice President, Finance

Auditors' Report

To the Shareholders of Surrey Metro Savings Credit Union

We have audited the consolidated balance sheets of Surrey Metro Savings Credit Union as at December 31, 1997 and 1996 and the consolidated statements of income, retained earnings and changes in financial position for the years then ended. These financial statements are the responsibility of the credit union's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the credit union as at December 31, 1997 and 1996 and the results of its operations and changes in its financial position for the years then ended in accordance with generally accepted accounting principles. As required by the Financial Institutions Act of British Columbia, we report that, in our opinion, these principles have been applied, after giving retroactive effect to the accounting changes described in Note 2 to the consolidated financial statements, on a consistent basis.

Doane Raymond

Chartered Accountants
New Westminster, Canada
February 13, 1998

Consolidated Balance Sheets

December 31 / in thousands of dollars	*Note*	**1997**	*(See Note 2)* 1996
Assets			
Cash resources	3	**223,284**	192,745
Securities	4	**—**	27,217
Loans	5	**1,668,350**	1,548,486
Other	6	**15,027**	17,254
Premises and equipment	7	**22,716**	22,465
		1,929,377	1,808,167
Liabilities			
Deposits	8	**1,723,157**	1,619,261
Other	9	**13,073**	12,369
Borrowings	10	**110,000**	100,000
		1,846,230	1,731,630
Subordinated notes	11	**10,000**	10,000
Shareholders' Equity			
Share capital	12	**276**	276
Retained earnings	13	**72,871**	66,261
		73,147	66,537
		1,929,377	1,808,167
Commitments	18		

See accompanying notes to the consolidated financial statements.

On behalf of the Board

Director

Director

Consolidated Statements of Income

Years Ended December 31 *in thousands of dollars, except per share amounts*	*Note*	**1997**	1996
Interest income	14		
Loans		**117,603**	122,969
Cash resources		**6,622**	9,043
Securities		**2,474**	5,867
Other		**274**	683
		126,973	138,562
Interest expense			
Deposits		**73,932**	85,427
Borrowings		**9,152**	9,672
		83,084	95,099
Net interest income		**43,889**	43,463
Provision for credit losses		**984**	1,031
		42,905	42,432
Other income	15	**15,068**	13,235
		57,973	55,667
Non-interest expenses			
Salaries and employee benefits		**23,557**	22,536
Occupancy		**6,015**	5,644
General	16	**16,563**	15,404
		46,135	43,584
Net income before income taxes		**11,838**	12,083
Provision for income taxes	17	**2,963**	2,978
Net income		**8,875**	9,105
in thousands Average number of non-voting shares		**5,664**	5,660
Earnings per non-voting share		**1.57**	1.61

See accompanying notes to the consolidated financial statements.

Consolidated Statements of Retained Earnings

Years Ended December 31 / in thousands of dollars	Note	1997	1996
Beginning of year			
As previously reported		**66,261**	61,115
Adjustment for change in accounting policy	2	—	(1,695)
As restated		**66,261**	59,420
Net income		**8,875**	9,105
Dividends on non-voting shares		**(2,265)**	(2,264)
End of year		**72,871**	66,261

See accompanying notes to the consolidated financial statements.

Consolidated Statements of Changes in Financial Position

Years Ended December 31/ in thousands of dollars	1997	(See Note 2) 1996
Cash resources provided by (used in)		
Operating activities		
Net income	**8,875**	9,105
Items not affecting cash resources:		
Amortization of premises and equipment	**3,975**	3,614
Amortization of goodwill	**11**	436
Deferred income taxes	**(415)**	(165)
Provision for credit losses	**984**	1,031
Changes in accrued interest receivable and payable	**(4,991)**	(4,894)
Changes in other non-cash operating items	**2,643**	3,822
	11,082	12,949
Financing activities		
Increase in deposits, net	**108,865**	101,303
Increase (decrease) in borrowings, net	**10,000**	(23,000)
Increase in subordinated notes	—	10,000
Issue of non-voting shares, for cash	—	68
Cash dividends on non-voting shares	**(2,265)**	(2,264)
	116,600	86,107
Investing activities		
Increase in loans, net	**(153,991)**	(105,211)
Proceeds from sale of loans	**33,165**	—
Purchase of premises and equipment, net	**(4,226)**	(3,285)
Decrease in securities	**27,217**	29,961
Decrease (increase) in investments and other	**692**	(1,168)
	(97,143)	(79,703)
Increase in cash resources	**30,539**	19,353
Cash resources, beginning of year	**192,745**	173,392
Cash resources, end of year	**223,284**	192,745

See accompanying notes to the consolidated financial statements.

Notes to the Consolidated Financial Statements

December 31, 1997 and 1996
all tabular amounts are in thousands of dollars, except per share amounts

Governing legislation and operations
Surrey Metro Savings Credit Union (SMS) is incorporated under the Credit Union Incorporation Act of British Columbia; the operation of SMS is subject to the Financial Institutions Act of British Columbia.

1. Significant accounting policies

These consolidated financial statements have been prepared in accordance with accounting practices generally accepted in Canada. In preparing these consolidated financial statements management has made estimates and assumptions that affect the amounts reported. Actual results could differ from those estimates.

Basis of consolidation
The consolidated financial statements include the assets, liabilities and results of operations of SMS and its wholly owned subsidiaries, Metro Insurance Services Ltd. and Shoreline Projects Ltd.

Securities
Securities consisting of Investment Account Securities are purchased with the intention of holding to maturity. These debt securities are stated at cost. Premiums and discounts on the purchase of debt securities are amortized to interest income from securities using the yield method over the period to maturity of the related securities.

Loans
Loans are stated at the unpaid principal plus accrued interest less an allowance established to provide against probable losses on ultimate realization of the loan portfolio.

Loan interest
Interest income from loans is recorded by the accrual method, except for impaired loans classified as non-accrual. Interest income from loans classified as non-accrual is recorded on a cash basis into revenue when there exists no allowance for credit loss against the principal amount. In cases where an allowance for credit loss exists against the principal, and interest is paid on a cash basis, amounts so received would be used to reduce the principal.

Loan fees
Penalty income recorded on prepayment or renegotiation of fixed-term loans is deferred and amortized to income over the average term of such loans (see Note 2 - Accounting changes).

Sale of loans
SMS, in the normal course of business, sells groups of loans. These sales transfer the risk and rewards of ownership and therefore meet accepted criteria for recognition as sales. Consequently, the assets from the sales are removed from the financial statements.

Gains on such arrangements are recognized in the year of sale and are derived by capitalizing the net present value of the interest spread inherent in the pool. Revenue from service fees earned for administration is recorded in other income.

Allowances for credit losses
SMS maintains specific allowances for credit losses that reduce the book value of loans identified as impaired to their estimated realizable amounts. An impaired loan is classified as non-accrual at the earlier of:

- in the opinion of management, there is reasonable doubt as to the collectibility of principal or interest
- interest is 90 days past due unless there is adequate security
- interest is 180 days past due.

Estimated realizable amounts are determined by discounting the expected future cash flows at the effective interest rate inherent in the loans, or by estimating the fair value of security underlying the loans and deducting costs of realization, or by estimating market prices for the loans.

SMS maintains a general allowance to absorb credit losses attributable to any deterioration of loan quality of the portfolio for which specific allowances cannot yet be determined. The general allowance is established based on payment arrears, known risks in the portfolio, historical credit loss experience and current economic conditions and trends.

Write-offs are generally recorded after all reasonable restructuring or collection activities have taken place and the possibility of further recovery is considered to be remote.

Investments
Investments are recorded at the lower of estimated net realizable value and cost.

Premises and equipment
Premises and equipment are recorded at cost less amortization which is provided using the straight line method over the estimated useful lives of the assets, as follows:

Buildings	40 to 50 years
Leasehold improvements	10 years
Computer and telephone equipment	3 to 4 years
Furniture and other equipment	5 to 10 years

Goodwill
Goodwill is recorded at cost less amortization which is provided using the straight line method over five years, except where a write-down is required to reflect permanent impairment.

Dividends
Dividends on preferred shares classified as deposit liabilities are charged to income for the year in respect of which they are calculated and are included in interest expense.

Dividends on non-voting shares classified as equity are charged to retained earnings in the year that they are declared.

Deferred income taxes
SMS provides for income taxes using the tax allocation method whereby provisions for income taxes are recorded when the revenues or expenses giving rise to the taxes are recognized in the consolidated financial statements, rather than when such items are taxed. The amounts in respect of such timing differences are recorded as deferred income taxes.

Derivatives
SMS enters into interest rate swap agreements and other derivative financial instruments to manage its exposure to interest rate risk. Interest rate swaps are normally designated as hedges (reducing interest rate risk), and any gains or losses are recognized on the same basis as, and netted against, the interest income or expense related to the hedged item.

Assets under administration
SMS administers certain assets either in the capacity of custodian for others or that have been securitized and sold. Assets under administration are not the property of SMS and are not reflected in the financial statements. Revenue from service fees earned for administration is recorded in other income.

Comparative figures
Certain comparative figures have been reclassified to conform with the current year's financial statement presentation.

2. Accounting changes

During 1997, Canadian accounting practices prescribed a new standard for presentation and disclosure of certain equity shares. Preferred shares formerly classified as part of shareholders' equity are now reported as deposit liabilities, while related dividends on preferred shares continue to be charged to interest expense. The effect of the retroactive application of this new standard is an increase in deposit liabilities and a corresponding decrease in share capital of $7,592,000 at December 31, 1996, with no effect on net income or retained earnings.

During the fiscal year 1996, SMS changed its accounting policy for recording penalty income on prepayment or renegotiation of fixed term loans. Previously, the penalty income was recognized when received. SMS now defers and amortizes the penalty over the average term of such loans. The retroactive effect of the change in accounting policy is a cumulative reduction of opening retained earnings as at January 1, 1996 of $1,695,000 (being net of taxes of $377,000) and a decrease of 1996 net income of $524,000 (net of $172,000 taxes).

3. Cash resources

	1997	1996
Cash on hand, deposits with banks and Credit Union Central of British Columbia, cheques and other items in transit	**9,551**	7,670
Demand and term deposits with Credit Union Central of British Columbia, due within one year	**202,933**	174,266
Bankers acceptances, commercial paper and other money market notes, due within one year	**8,247**	8,117
Accrued interest	**2,553**	2,692
	223,284	192,745

4. Securities

	1997 Cost	1997 Estimated market value	1996 Cost	1996 Estimated market value
Canadian Government debt	—	—	7,761	8,199
Other Canadian debt securities	—	—	19,456	20,617
	—	—	27,217	28,816

5. Loans

	Residential Mortgages	Personal Loans	Commercial Mortgages and Loans	Total
1997				
Loan principal	**1,259,699**	**172,621**	**233,795**	**1,666,115**
Accrued interest	**3,538**	**276**	**1,573**	**5,387**
Total loans	**1,263,237**	**172,897**	**235,368**	**1,671,502**
Allowance for credit losses	**922**	**958**	**1,272**	**3,152**
	1,262,315	**171,939**	**234,096**	**1,668,350**
Impaired loans	**3,667**	**111**	**67**	**3,845**
Less amounts where loss is not expected	**3,464**	—	—	**3,464**
Specific allowances	**203**	**111**	**67**	**381**
General allowances	**719**	**847**	**1,205**	**2,771**
	922	**958**	**1,272**	**3,152**
1996				
Loan principal	1,216,568	148,593	180,963	1,546,124
Accrued interest	4,090	252	1,023	5,365
Total loans	1,220,658	148,845	181,986	1,551,489
Allowance for credit losses	1,108	932	963	3,003
	1,219,550	147,913	181,023	1,548,486
Impaired loans	4,604	243	156	5,003
Less amounts where loss is not expected	4,297	44	89	4,430
Specific allowances	307	199	67	573
General allowances	801	733	896	2,430
	1,108	932	963	3,003

	1997	1996
Allowance for credit losses		
Balance, beginning of year	**3,003**	2,519
Provision, before recoveries of $206 (1996 - $131)	**1,190**	1,162
	4,193	3,681
Write-offs	**(1,041)**	(678)
Balance, end of year	**3,152**	3,003
Percentage of total loans	**0.19**	0.19

6. Other assets

	1997	1996
Investments		
Shares, Credit Union Central of British Columbia	**9,947**	9,984
Other		
Accounts receivable	**580**	1,623
Deferred leasing costs	**206**	268
Prepaid expenses	**3,063**	4,052
Deferred income taxes	**984**	569
Other	**247**	758
	5,080	7,270
	15,027	17,254

7. Premises and equipment

	Cost	Accumulated Amortization	1997 Net Book Value	1996 Net Book Value
Land	3,402	—	**3,402**	3,402
Buildings	12,172	4,303	**7,869**	7,896
Leasehold improvements	5,507	2,163	**3,344**	3,232
Computer and telephone equipment	12,336	7,858	**4,478**	4,748
Furniture and other equipment	10,907	7,284	**3,623**	3,187
	44,324	21,608	**22,716**	22,465

8. Deposits

	1997	(See Note 2) 1996
Demand	**272,718**	303,646
Term	**903,136**	770,838
Registered savings plans	**510,101**	502,810
Preferred shares	**7,796**	7,592
Accrued interest	**29,406**	34,375
	1,723,157	1,619,261

Preferred shares included in deposits comprise an unlimited number of non-transferable, cumulative, redeemable shares with a par value of $1 each, issued as a condition of membership to a maximum of 1,000 shares per member. Each share is entitled to a cumulative dividend at a floating rate equal to SMS's average daily prime rate of interest during the year and is redeemable at par value on withdrawal of membership.

9. Other liabilities

	1997	1996
Deferred mortgage prepayment penalties	**4,025**	2,923
Interest payable	**2,610**	1,967
Deferred rental income	**724**	705
Taxes payable	**378**	1,074
Other, including accounts payable and accruals	**5,336**	5,700
	13,073	12,369

10. Borrowings

Maturity date	Interest rate *in percent*	1997	1996
Credit Union Central of British Columbia			
October 20, 1997	7.50	—	5,000
October 20, 1998	5.50	**5,000**	—
August 20, 1999	6.92	**10,000**	10,000
August 30, 2000	7.25	**10,000**	10,000
September 18, 2000	7.40	**20,000**	20,000
August 21, 2001	7.52	**5,000**	5,000
		50,000	50,000

10. Borrowings *(continued)*

Maturity date	Interest rate *in percent*	1997	1996
Syndicated bank borrowings			
January 3, 1997	5.87	—	20,000
August 21, 1997	4.75	—	30,000
January 8, 1998	3.79	**20,000**	—
February 17, 1998	3.94	**20,000**	—
May 19, 1998	4.21	**20,000**	—
		60,000	50,000
		110,000	100,000

Subsequent to the year-end, matured borrowings were renegotiated in the normal course of business.

Credit Union Central of British Columbia

The borrowings are secured by a demand debenture in the amount of $57,000,000 in favour of Credit Union Central of British Columbia, which creates a floating charge on assets and undertakings of SMS, and an assignment of book debts. Interest is payable semiannually.

Syndicated bank borrowings

Borrowings syndicated by four financial institutions, for up to $100,000,000 (1996 - $100,000,000) are secured by a $200,000,000 floating charge and a security interest on assets and undertakings of SMS. The syndicated bank borrowings are subordinated in right of repayment to the Credit Union Central of British Columbia borrowings. Repayment of individual term loans provided under these borrowings is required by no later than June 2001. This maturity date may be extended by mutual agreement. Interest is payable every 30 days for term loans due within 6 months and not less than semiannually for term loans of longer duration.

11. Subordinated notes

Unsecured notes in the amount of $10,000,000 (1996 - $10,000,000) bearing interest at 8.98% per annum payable semiannually and maturing on October 4, 2006. These notes are redeemable after October 4, 2001 and are subordinated in right of repayment to Credit Union Central of British Columbia, borrowings and deposits.

12. Share capital

Authorized:

Non-voting shares

An unlimited number of transferable non-voting shares with a par value of $0.005 each, fully participating in earnings after payment of dividends on preferred shares.

First preferred shares

An unlimited number of retractable first preferred shares without par value and without fixed dividend entitlements.

Issued and outstanding:

	1997		1996	
	Number of Shares	**Amount**	Number of Shares	Amount
Non-voting shares				
Beginning of year	**5,663,672**	**276**	5,655,672	208
Issued	—	—	8,000	68
End of year	**5,663,672**	**276**	5,663,672	276

First preferred shares

As at December 31, 1997, there are no first preferred shares issued and outstanding.

Stock options

Certain key employees have been granted options to purchase non-voting shares at prices based on the market price of the shares as determined on the date of the grant. The total stock options outstanding at December 31, 1997 are as follows:

Year Granted	Price per Share	Expiry Date	Number of Shares
1992	6.00	October 28, 2002	11,000
1993	9.88	November 3, 2003	11,000
1994	11.00	November 1, 2004	17,000
1995	8.50	October 30, 2005	32,000
1996	9.13	January 22, 2006	8,000
1996	11.40	October 28, 2006	44,000
1997	12.05	October 27, 2007	44,000
			167,000

13. Capital requirements

The Financial Institutions Act requires SMS to maintain a capital base which is adequate in relation to its level of business activities. The level of capital required is based on a prescribed pecentage of the total value of its risk-weighted assets, each asset of SMS being assigned a risk factor based on the probability that a loss may be incurred on ultimate realization of that asset.

The Financial Institutions Act regulations prescribe that the minimum required capital base is 8% of the risk-weighted value of assets. At December 31, 1997, SMS had a capital base of 10.4% (1996 - 10.4%) of the total value of risk-weighted assets.

14. Interest income

Interest income from loans includes $1,997,000 (1996 - $1,992,000) of penalty income recorded for prepayment or renegotiation of fixed-term loans.

Interest income from securities includes interest of $1,720,000 (1996 - $4,530,000) and net realized gains of $754,000 (1996 - $1,337,000).

15. Other income

	1997	1996
Account service fees	**7,026**	6,437
Commissions	**4,829**	3,925
Lending fees	**1,992**	1,904
Other	**1,221**	969
	15,068	13,235

16. General operating expenses

	1997	1996
Bonding and other insurance	**440**	382
Capital taxes	**808**	791
Chequing service charges	**1,225**	1,093
Data processing	**3,967**	3,859
Deposit insurance assessment	**811**	780
Dues, Credit Union Central of British Columbia	**519**	459
Marketing	**2,311**	1,952
Professional and other services	**2,038**	1,684
Stationery, telephone and postage	**2,644**	2,525
Sundry	**1,800**	1,879
	16,563	15,404

17. Income taxes

	1997	1996
Provision for income taxes		
Current	**3,378**	3,143
Deferred	**(415)**	(165)
	2,963	2,978
Reconciliation of income tax rate (in percent)		
Combined federal and provincial income tax rate	**45.6**	45.6
Increase (decrease) resulting from:		
Adjustments for income eligible for reduced rate	**(23.5)**	(23.0)
Adjustments for income not eligible for reduced rate	**.6**	—
Other, net	**2.3**	2.0
	25.0	24.6

The effective income tax rate is less than the basic Canadian corporation tax rate primarily as a result of an income tax rate reduction available to credit unions of up to 23.5%. Eligibility for this reduction is based upon the relationship between the level of deposits and accumulated pretax earnings that were previously taxed at the reduced rates. For fiscal 1997, the total deposits outstanding at the year-end were not sufficient to make SMS eligible for the reduced tax rate on all its taxable income. The excess portion of taxable income is subject to income tax at the basic Canadian corporation tax rate.

18. Commitments

Lease commitments

SMS occupies branch premises under long-term leases extending to 2005. Aggregate basic annual lease payments for each of the next five years are:

in dollars	
1998	1,676,000
1999	1,544,000
2000	1,403,000
2001	1,188,000
2002	811,000

Off-balance sheet commitments

In the normal course of business, SMS enters into various off-balance sheet commitments such as letters of credit and derivative contracts. The letters of credit and the notional principal amounts for derivative contracts reported below are not reflected in the consolidated balance sheets. Details of these are as follows:

Letters of credit

At December 31, 1997, SMS has outstanding letters of credit on behalf of customers in the amount of $11,899,000 (1996 - $4,924,000). These letters of credit are fully secured by monies on deposit.

Derivative contracts

Interest rate swaps

At December 31, 1997, SMS has outstanding interest rate swap contracts in the notional principal amount of $80,000,000 (1996 - $120,000,000) maturing at various times in part until 2001. Interest rate swaps are transactions in which two parties exchange interest flows on a specified notional principal amount for a pre-determined period based on agreed-upon fixed and floating rates. Principal amounts are not exchanged and are not indicative of a credit exposure.

19. Maturities

	Period to Maturity					
	Within 3 Months	4 Months to 1 Year	Over 1 to 5 Years	Not Interest Sensitive	Total	Average Rates %
1997						
Assets						
Cash resources	101,516	109,665	—	12,103	223,284	3.86
Loans						
Fixed	71,251	178,367	1,082,259	2,235	1,334,112	7.05
Floating	334,238	—	—	—	334,238	7.66
Other	—	9,947	—	5,080	15,027	1.65
Premises and equipment	—	—	—	22,716	22,716	—
	507,005	297,979	1,082,259	42,134	1,929,377	6.66
Liabilities						
Deposits	628,474	422,261	643,016	29,406	1,723,157	4.30
Other	—	—	—	13,073	13,073	—
Borrowings	40,000	25,000	45,000	—	110,000	5.75
Subordinated notes	—	—	10,000	—	10,000	8.98
Equity	—	—	—	73,147	73,147	—
	668,474	447,261	698,016	115,626	1,929,377	4.14
	(161,469)	(149,282)	384,243	(73,492)	—	
Derivatives, net	40,000	—	(40,000)	—	—	
Net mismatch	(121,469)	(149,282)	344,243	(73,492)	—	

Maturity dates substantially coincide with interest adjustment dates. Amounts with floating rates, or due on demand, are classified as maturing within three months, regardless of maturity. Amounts that are not interest sensitive are grouped together, regardless of maturity.

A significant amount of loans and deposits can be settled before maturity on payment of a penalty. No adjustment has been made for repayments that may occur prior to maturity.

19. Maturities *(continued)*

	Period to Maturity Within 3 Months	4 Months to 1 Year	Over 1 to 5 Years	Not Interest Sensitive	Total	Average Rates %
1996						
Assets						
Cash resources	131,676	47,500	—	13,569	192,745	3.57
Securities		10,500	17,000	(283)	27,217	8.80
Loans						
Fixed	90,039	250,358	979,302	2,335	1,322,034	7.59
Floating	226,452	—	—	—	226,452	6.93
Other	—	9,984	—	7,270	17,254	3.47
Premises and equipment	—	—	—	22,465	22,465	—
	448,167	318,342	996,302	45,356	1,808,167	6.96
Liabilities						
Deposits	619,083	522,631	443,310	34,237	1,619,261	4.44
Other	—	—	—	12,369	12,369	—
Borrowings	20,000	35,000	45,000	—	100,000	6.50
Subordinated notes	—	—	10,000	—	10,000	8.98
Equity	—	—	—	66,537	66,537	—
	639,083	557,631	498,310	113,143	1,808,167	4.39
	(190,916)	(239,289)	497,992	(67,787)	—	
Derivatives, net	80,000	—	(80,000)	—	—	
Net mismatch	(110,916)	(239,289)	417,992	(67,787)	—	

20. Fair values of financial instruments

Estimated fair values of SMS's financial instruments are set out below. No fair values have been determined for premises and equipment, goodwill or any other asset and liability that is not a financial instrument. The estimated fair values of cash resources, variable rate loans, other assets and liabilities are assumed to equal their book values. The fair values of fixed-rate loans and deposits are determined by discounting the expected future cash flows at the estimated current market rates for loans and deposits with similar characteristics.

	1997 **Book Value**	**Fair Value**	**Fair value over (under) book value**	1996 Book Value	Fair Value	Fair value over (under) book value
Assets						
Cash resources	**223,284**	**223,284**	**—**	192,745	192,795	—
Securities	**—**	**—**	**—**	27,217	28,816	1,599
Loans	**1,668,350**	**1,677,822**	**9,472**	1,548,486	1,590,782	42,296
Other	**9,947**	**9,947**	**—**	9,984	9,984	—
Liabilities						
Deposits	**1,723,157**	**1,729,137**	**5,980**	1,619,261	1,660,939	41,678
Borrowings	**110,000**	**110,358**	**358**	100,000	103,774	3,774
Subordinated notes	**10,000**	**10,329**	**329**	10,000	10,450	450
Derivative						
Financial instruments	**—**	**(2,508)**	**(2,508)**	—	(6,979)	(6,979)

The difference between the book and fair values of SMS's loans, deposits and other financial instruments is due primarily to changes in interest rates. As SMS normally holds these instruments to maturity, the book values have not been adjusted to reflect the differences. Not all financial instruments are readily marketable. As a result, the estimates of fair value are subjective and should not be considered precise.

21. Other information

At December 31, 1997 outstanding loans to directors, officers and employees totalled $36,370,000 (1996 - $34,080,000), which included 317 mortgages totalling $31,833,000 and 1,061 other loans totalling $4,537,000.

During the year, directors, in their capacity as directors, received remuneration of $95,000 (1996 - $92,000).

22. Subsequent event

Subsequent to the year-end, SMS received regulatory approval to commence a non-voting share repurchase program on February 17, 1998 for a period of one year. SMS can repurchase up to 283,183 non-voting shares, representing 5% of its issued and outstanding non-voting shares. The non-voting shares will be cancelled upon repurchase.

Selected Quarterly Consolidated Financial Data

Unaudited		*(See Note 2)*		*(See Note 2)*		*(See Note 2)*		*(See Note 2)*
in thousands of dollars	**Dec 31/97**	Dec 31/96	**Sep 30/97**	Sep 30/96	**Jun 30/97**	Jun30/96	**Mar 31/97**	Mar 31/96
Balance Sheets								
Assets								
Cash Resources	**223,284**	192,745	**183,686**	183,452	**182,871**	172,989	**177,852**	165,434
Securities	**—**	27,217	**19,304**	49,240	**24,274**	54,215	**27,246**	54,191
Loans	**1,668,350**	1,548,486	**1,662,528**	1,538,240	**1,624,522**	1,528,472	**1,598,720**	1,498,612
Other	**15,027**	17,254	**15,563**	17,796	**15,396**	16,148	**15,952**	15,070
Premises and Equipment	**22,716**	22,465	**21,998**	22,064	**21,757**	22,551	**21,964**	22,756
	1,929,377	1,808,167	**1,903,079**	1,810,792	**1,868,820**	1,794,375	**1,841,734**	1,756,063
Liabilities								
Deposits	**1,723,157**	1,619,261	**1,625,407**	1,611,021	**1,623,187**	1,590,653	**1,616,432**	1,546,716
Other	**13,073**	12,369	**9,646**	9,525	**16,298**	12,994	**9,002**	7,744
Borrowings	**110,000**	100,000	**186,000**	125,000	**150,000**	128,000	**138,000**	140,000
	1,846,230	1,731,630	**1,821,053**	1,745,546	**1,789,485**	1,731,647	**1,763,434**	1,694,460
Subordinated Notes	**10,000**	10,000	**10,000**	—	**10,000**	—	**10,000**	—
Shareholders' Equity								
Share Capital	**276**	276	**276**	276	**276**	208	**276**	208
Retained Earnings	**72,871**	66,261	**71,750**	64,970	**69,059**	62,520	**68,024**	61,395
	73,147	66,537	**72,026**	65,246	**69,335**	62,728	**68,300**	61,603
	1,929,377	1,808,167	**1,903,079**	1,810,792	**1,868,820**	1,794,375	**1,841,734**	1,756,063
Income Statements								
Interest Income	**33,071**	34,361	**31,701**	34,484	**31,324**	34,687	**30,877**	35,030
Interest Expense	**20,806**	22,017	**20,864**	23,885	**20,702**	24,142	**20,712**	25,055
Net Interest Income	**12,265**	12,344	**10,837**	10,599	**10,622**	10,545	**10,165**	9,975
Provision for Credit Losses	**429**	549	**149**	253	**202**	120	**204**	109
	11,836	11,795	**10,688**	10,346	**10,420**	10,425	**9,961**	9,866
Other Income	**3,654**	3,412	**4,034**	3,273	**3,629**	3,174	**3,751**	3,376
	15,490	15,207	**14,722**	13,619	**14,049**	13,599	**13,712**	13,242
Non-Interest Expenses	**12,479**	11,985	**11,133**	10,363	**11,112**	10,611	**11,411**	10,625
	3,011	3,222	**3,589**	3,256	**2,937**	2,988	**2,301**	2,617
Provision for Income Taxes	**757**	798	**896***	806	**772***	732	**538**	642
Net Income	**2,254**	2,424	**2,693***	2,450	**2,165***	2,256	**1,763**	1,975
In dollars Earnings per Share	**$0.40**	$0.43	**$0.48**	$0.43	**$0.38**	$0.40	**$0.31**	$0.35

** restated from previously released quarterly reports to reflect a reduction from the then anticipated corporation tax rate of approximately 30% to the actual rate of 25% for the fiscal 1997.*

Eight-Year Overview

As at December 31/in thousands of dollars	**1997**	*(See Note 2)* 1996	*(See Note 2)* 1995	*(See Note 2)* 1994	*(See Note 2)* 1993	*(See Note 2)* 1992	*(See Note 2)* 1991	*(See Note 2)* 1990
Balance Sheets								
Assets								
Cash Resources	**223,284**	192,745	173,392	149,428	149,692	161,400	143,682	173,184
Securities	**—**	27,217	57,178	44,873	—	—	—	—
Loans	**1,668,350**	1,548,486	1,444,649	1,221,162	1,056,657	964,559	841,739	697,570
Other	**15,027**	17,254	16,514	15,137	15,361	14,708	15,252	19,964
Premises and Equipment	**22,716**	22,465	22,794	18,471	15,412	14,499	13,867	12,591
	1,929,377	1,808,167	1,714,527	1,449,071	1,237,122	1,155,166	1,014,540	903,309
Liabilities								
Deposits								
Demand	**280,529**	311,254	281,187	274,229	289,041	323,102	335,981	342,185
Term	**916,888**	785,605	772,415	652,222	531,321	465,617	378,794	332,947
RRSP	**525,740**	522,402	469,592	371,643	313,653	268,781	230,723	199,046
	1,723,157	1,619,261	1,523,194	1,298,094	1,134,015	1,057,500	945,498	874,178
Other	**13,073**	12,369	8,705	10,141	10,439	13,127	9,750	4,197
Borrowings	**110,000**	100,000	123,000	84,000	45,000	45,000	30,000	3,250
	123,073	112,369	131,705	94,141	55,439	58,127	39,750	7,447
Subordinated Notes	**10,000**	10,000	—	3,000	3,000	3,000	3,000	3,000
Shareholders' Equity								
Share Capital	**276**	276	208	76	76	28	—	—
Retained Earnings	**72,871**	66,261	59,420	53,760	44,592	36,511	26,292	18,684
	73,147	66,537	59,628	53,836	44,668	36,539	26,292	18,684
	1,929,377	1,808,167	1,714,527	1,449,071	1,237,122	1,155,166	1,014,540	903,309
Years Ended December 31/in thousands of dollars								
Income Statements								
Interest Income	**126,973**	138,562	134,507	106,397	100,150	102,672	104,696	103,855
Interest Expense	**83,084**	95,099	96,530	67,079	64,868	70,983	77,156	82,342
Net Interest Income	**43,889**	43,463	37,977	39,318	35,282	31,689	27,540	21,513
Provision for Credit Losses	**984**	1,031	466	491	492	527	495	559
	42,905	42,432	37,511	38,827	34,790	31,162	27,045	20,954
Other Income	**15,068**	13,235	11,975	11,591	10,598	10,017	8,692	8,572
	57,973	55,667	49,486	50,418	45,388	41,179	35,737	29,526
Non-Interest Expenses	**46,135**	43,584	39,059	35,353	32,583	30,537	25,886	22,140
Net Income Before Income Taxes	**11,838**	12,083	10,427	15,065	12,805	10,642	9,851	7,386
Income Taxes								
Current	**3,378**	3,143	2,050	3,328	3,334	3,425	2,628	1,726
Deferred	**(415)**	(165)	456	313	(302)	(1,080)	(385)	(181)
	2,963	2,978	2,506	3,641	3,032	2,345	2,243	1,545
Net Income	**8,875**	9,105	7,921	11,424	9,773	8,297	7,608	5,841
Financial Statistics								
in percent **Asset Growth**	**6.70**	5.50	18.30	17.10	7.09	13.86	12.31	9.21
in percent **Loan Growth**	**7.70**	7.20	18.30	15.60	9.54	14.59	20.67	13.35
in percent **Deposit Growth**	**6.40**	6.31	17.34	14.47	7.24	11.85	8.18	9.55
Percentage of Average Assets								
Net Interest Income	**2.35**	2.45	2.41	2.97	2.92	2.90	2.87	2.46
Other Income	**0.81**	0.74	0.76	0.88	0.89	0.92	0.91	0.99
Non-Interest Expenses	**2.47**	2.45	2.48	2.67	2.73	2.82	2.70	2.56
Percentage Return On								
Average Assets	**0.47**	0.51	0.50	0.86	0.81	0.76	0.79	0.68
Average NV Equity	**12.70**	14.42	14.02	23.26	24.19	25.83	33.46	35.91
in dollars **Book Value Per NV Share**	**12.92**	11.75	10.54	9.55	7.92	6.49	4.68	3.40
in dollars **Earnings Per NV Share**	**1.57**	1.61	1.40	2.03	1.73	1.47	1.35	1.04
in dollars **Earnings Per NV Share Fully Diluted**	**1.53**	1.59	1.39	2.02	1.72	1.47	1.35	1.04

Corporate Governance

The Board of Directors of Surrey Metro Savings has adopted policies and procedures essential to the effective and prudent operation of Surrey Metro Savings, in keeping with guidelines established by The Toronto Stock Exchange (TSE) Committee on Corporate Governance.

Mandate and Responsibilities of the Board

The fundamental objective of the Board of Directors of Surrey Metro Savings is to create value for the members and shareholders, and to protect the value of the Company against erosion. The Board's duties and responsibilities are carried out in a manner consistent with that fundamental objective.

The principal duty and responsibility of the Board is to supervise the management of Surrey Metro Savings, with the day-to-day management of the business and affairs of the Company delegated by the Board to the CEO and other executive officers.

The Board's responsibilities include overseeing the conduct of the Company's business, providing leadership and direction to its management, and setting policies. Long-term goals and strategies for the Company are developed as part of the Board's annual strategic planning process. Through this process, the Board adopts the operating plan for the coming year, and monitors management's relative progress through a regular reporting and review process. The Board identifies the principal risks of the business, and monitors these through established systems, policies, procedures and control mechanisms. Through the CEO, the Board sets standards of conduct, including the general moral and ethical standards for the conduct of the business as a leading financial institution.

Composition of the Board

Our nine-member Board of Directors is elected by the members of Surrey Metro Savings, with one being related. Lloyd Craig, in addition to serving as a director, is the Company's President and Chief Executive Officer. Mr. Craig is not eligible to serve as Chairman of the Board. The eight unrelated directors are independent of management and are free from any interest, business or other relationships that could, or could reasonably be perceived to, materially interfere with their ability to act in the best interests of the Company.

Board Meetings and Procedures

There are seven regularly scheduled meetings of the Board of Directors held each year. In addition, a Board/Management planning session is held to discuss strategic issues. Special meetings of the Board are held as required. Each committee of the Board meets as required to carry out its mandate as described in its terms of reference.

Prior to each Board meeting, the directors receive a comprehensive information package including the agenda, minutes of the previous Board and committee meetings, and material relating to items on the agenda. The Board utilizes a consent agenda process for routine matters in order to free up the Board's time for matters of strategic importance.

The Board has adopted a policy that enables the Board of Directors, Board committees, or an individual director, to engage an outside advisor at the expense of Surrey Metro Savings with the authority of the Governance Committee or the Board of Directors.

Committees of the Board

The Board has six standing committees: Executive, Audit, Human Resources, Conduct Review, Governance, and Investment and Loan. Each committee is comprised of three directors, and the Chair and CEO serve ex-officio on those committees to which they have not otherwise been elected or appointed. Each committee also has available to it as resource such members of management as may from time to time be determined to be appropriate. The Board determines the powers and responsibilities of each committee, and reviews the authority and mandate of each committee annually. The Chair of each Board committee reports to the full Board after each committee meeting.

The *Executive Committee* acts as a sounding board for the CEO on matters requiring Board involvement. This committee also acts in emergency circumstances as required between meetings of the full Board of Directors, and is responsible for representing the Company in certain financial services industry and public relations matters.

The *Audit Committee* assesses, influences, and helps set the tone for quality financial reporting and sound internal controls. The committee reviews the financial statements and recommends their approval to the Board. It also assesses the accounting principles and underlying risks, and assesses the adequacy and effectiveness of internal controls.

The *Human Resources Committee* reviews and assesses the CEO's achievement of corporate objectives, and also analyzes the policies and strategies with respect to the payment of salaries and benefits, incentive compensation, and succession planning, which includes the appointment, training and monitoring of senior management.

The *Conduct Review Committee* ensures that policies and procedures are in place to deal with related party transactions, conflicts of interest, and disclosure of identity to customers as it relates to third-party transactions.

The *Governance Committee* oversees the corporate governance system of Surrey Metro Savings. The committee ensures that the mission and strategic direction of Surrey Metro Savings is reviewed annually and that the Board and its committees carry out their functions in accordance with due process. In addition, this committee assesses the effectiveness of the Board and its committees, and the contributions of each individual director. The committee has the responsibility to address governance issues, and to identify, recruit, nominate, endorse, recommend appointment of, and ensure orientation for new directors.

The *Investment and Loan Committee* is mandated to ensure that the Company adheres to prudent standards in making investment and lending decisions, in giving guarantees and committing the Company to other financial obligations, in writing down the value of investments and loans on its books, and in managing its investments and loans, including its subsidiary companies.

Relationship with and Expectations of Management

The Board has delegated to the CEO and senior management the responsibility for day-to-day management of the business of Surrey Metro Savings. Matters of policy and issues outside the normal course of business are brought before the Board for their review and approval, along with all matters dictated by statute and legislation. The CEO and senior management team review the Company's progress at Board meetings, which are held at least seven times a year. Financial, operational, and strategic issues facing the Company are reviewed, monitored and approved at the Board meetings.

Recruitment of New Directors and Assessment of Board Performance

The Governance Committee of the Board is responsible for assessing the effectiveness of the Board as a whole, and the contribution of each individual director. The committee identifies, recruits, nominates, endorses, recommends appointment of (where applicable) and ensures orientation of new directors. The Governance Committee annually develops criteria which reflect the needs of the Board in recruiting new directors. The committee meets with, interviews and evaluates potential candidates to ensure that the Board is constituted with individuals of diverse background talents and experience and to ensure that when a vacancy occurs, qualified candidates are available.

Shareholder Feedback and Concern

The Senior Vice President, Finance, oversees an investor and shareholder relations program. The program involves providing information with respect to reported financial results and other announcements by the Company to a broad spectrum of investors and other stakeholders. Shareholder concerns of a significant nature are directed to the Senior Vice President, Finance and the CEO, for information and resolve, and management reports to the Board on these matters and other major shareholder and investor matters.

Corporate Information

Board of Directors

Committee membership indicated by numbers following names

H.A. (Bert) Miles 1,2,3
Chairman
General Manager,
Burnaby Lake Greenhouses Ltd.

Bruce H. Chapman 1,4,6
Senior Vice Chairman
President and Chief Executive Officer
NII Norsat International Inc.

Frank L. Harper 1,5,6
Vice Chairman
President
Sphere Financial Ltd.

Lloyd M. Craig
President and Chief Executive Officer
Surrey Metro Savings

Dale M. Mumford 2,3
Principal
SDM Realty Advisors Ltd.

Douglas T. Stone 3
Director of Operations
Corporation of the City of White Rock

Rodney C. Bergen 4,5
President
ROI Management Systems Inc.

Michael A. McCartney 5,6
Partner
Bouchard and Co.

Amber J. Goddyn 2,4
Notary Public

Committees of the Board of Directors
1 Executive
2 Governance
3 Human Resources
4 Conduct Review
5 Investment and Loan
6 Audit

Executive Officers

Lloyd M. Craig
President and Chief Executive Officer

Hermann G. Bessert
Senior Vice President, Finance

Robert H. Caldwell
Senior Vice President, Operations

J. Patrick Hagan
Vice President, Information Systems

Kenneth G. Hahn
Vice President, Human Resources

Rodney A. Marr
Vice President, Credit

James E. Miller
Vice President, Marketing

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510 Burrard Street
Vancouver, BC V6C 3B9

Auditors
Doane Raymond
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New Westminster, BC V3M 1A6

Stock Exchange Listing
Toronto Stock Exchange (TSE)
Symbol: SMS

Annual Meeting
The 51st Annual Meeting will be held on Wednesday, May 13, 1998 at 7:30 p.m. at Coyote Creek Golf & Country Club 7778 – 152 Street, Surrey, BC, Canada.

Dividend
Surrey Metro Savings' current policy is to declare semiannual dividends for its Non-Voting Shares payable on December 1 and June 1 to shareholders of record on November 1 and May 1.

Surrey Metro Savings
Credit Union
15117 – 101 Avenue
Surrey, British Columbia
V3R 8P7